

Message Text

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EEC, ALSO FOR EMBASSY

PASS FEDERAL RESERVE AND COMMERCE

E. O. 11652: GDS
TAGS: EFIN, FR
SUBJECT: FORECAST OF THE FRENCH ECONOMY 1978 AND 1979

REF: PARIS 18577

SUMMARY

PRIME MINISTER BARRE CONTINUES TO PURSUE HIS DOUBLE
TASK OF ALLOWING THE MARKET TO HAVE A GREATER ROLE IN
RESTRUCTURING FRENCH ECONOMIC ACTIVITIES AND TO REDUCE
INFLATION. BOTH REQUIRE TOUGH POLITICAL DECISIONS AND
THE REDIRECTION OF RESOURCES IS BETTER DONE IN AN
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EXPANDING ECONOMY WHILE STABILIZATION IS FACILITATED
BY A STABLE OR CONTRACTING ONE. A CHOICE MAY HAVE TO BE
MADE, AND THE GOVERNMENT'S SALARY POLICY IS ONE PLACE
WHERE A COMPROMISE MAY BE MADE. AT THE MOMENT THERE IS
NO SIGN THAT IT WILL YIELD TO PRESSURES.

FRANCE CONTINUES TO BE ON A 3 PERCENT GROWTH TREND

WHICH MAY IMPROVE SLIGHTLY NEXT YEAR. ITS BALANCE OF PAYMENTS CURRENT ACCOUNT HAS IMPROVED REMARKABLY THIS YEAR IN PART BECAUSE OF TERMS OF TRADE GAINS, AND THE OUTLOOK IS FOR ONLY A SLIGHT DETERIORATION IN 1979. PRICE INCREASE BETWEEN 10 AND 11 PERCENT WILL BE WORSE THAN THE 9 PERCENT RISE OF 1977 BECAUSE ADMINISTERED PRICES HAVE RISEN TO REALISTIC LEVELS AND PRICE CONTROLS ON THE PRIVATE SECTOR LARGELY ELIMINATED. NEXT YEAR, A RIGOROUS POLICY ON SALARIES MAY BRING IT DOWN TO 9 PERCENT WHILE SLIPPAGE COULD RAISE IT AS HIGH AS 10 PERCENT. THE UNEMPLOYMENT RATE, NOW AT 6 PERCENT, WILL UNDER THE BEST OF CIRCUMSTANCES RISE NO HIGHER BUT IS MORE LIKELY TO DETERIORATE SOMEWHAT.

1. INTRODUCTION. THE GOVERNMENT'S VICTORY IN THE MARCH ELECTIONS HAS GIVEN IT THE POLITICAL LUXURY OF TIME TO WITHSTAND THE PRESSURES OF RISING UNEMPLOYMENT WHILE IT WORKS ON RESTRUCTURING OUTMODED OR REDUNDANT FACILITIES AND ATTEMPTS TO LOWER THE RATE OF INFLATION TO THE AVERAGE OF ITS TRADING PARTNERS. BOTH ACTIVITIES ARE PREREQUISITES TO MAKING THE FRENCH ECONOMY MORE COMPETITIVE INTERNATIONALLY. TO THE EXTENT THESE POLICIES ARE SUCCESSFUL, THE BALANCE OF PAYMENTS RESTRAINT ON EXPANSION WILL BE REDUCED AND THE ECONOMY WILL ENJOY A GREATER INSULATION FROM FOREIGN DEFLATIONARY OR INFLATIONARY IMPULSES. WITH THE PRESIDENTIAL

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ELECTION LESS THAN THREE YEARS AWAY, THE ADMINISTRATION PROBABLY HAS A MAXIMUM OF EIGHTEEN MONTHS IN WHICH IT CAN UNDERTAKE TOUGH POLICIES BEFORE THE DEMANDS OF THE CAMPAIGN TAKE OVER.

2. THE BARRE PLAN, WHICH HAS BEEN IN OPERATION IN ONE FORM OR ANOTHER SINCE LATE 1976, IS A BROADENING AND DEEPENING OF THE TRADITIONAL STABILIZATION PLAN. IN

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ADDITION TO THE ORTHODOX OBJECTIVES OF INTERNAL AND EXTERNAL EQUILIBRIUM, IT IS MOVING ON TO THE STIMULATION OF INVESTMENT IN PRODUCTIVE AREAS BY ALLOWING INDUSTRIALISTS GREATER FREEDOM TO RAISE PRICES AND NON-COMPETITIVE ACTIVITIES TO GO UNDER. THE BANKRUPTCY OF THE BOUSSAC TEXTILE EMPIRE, THE CONSIDERATION OF THE TERMINATION OF AN ALMOST COMPLETED MAJOR STEEL FACILITY IN LORRAINE, AND THE CONTINUING ROUND OF LAYOFFS WITHOUT OFFICIAL HINDRANCE SUGGEST THAT, IN THIS AREA, THE PRIME MINISTER HAS THE PRESIDENT'S FULL SUPPORT.

3. THE SETTING. THE BASIC TENDENCIES OF THE ECONOMY IN THE EIGHTEEN MONTHS ENDING IN MID-1978 ARE:

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(A) A 3 PERCENT GROWTH RATE SET BY WAGE POLICY ALLOWING A 2-3 PERCENT INCREASE IN ANNUAL PURCHASING POWER AND THE STEADY IMPROVEMENT OF THE BALANCE OF PAYMENTS CURRENT ACCOUNT;

(B) A 9 PERCENT PRICE RISE, THE NET EFFECT OF A 12-13 PERCENT WAGE RISE AND A 3-4 PERCENT IMPROVEMENT IN PRODUCTIVITY;

(C) A CURRENT ACCOUNT TENDING TOWARD SURPLUS AS RESULT OF A GROWTH RATE SIMILAR TO THAT OF ITS TRADING

PARTNERS, A SUBSTANTIAL IMPROVEMENT IN ITS TERMS OF TRADE, AND A FRANC SOMEWHAT UNDERVALUED BY PRE-ELECTORAL SPECULATION ON A LEFT VICTORY.

4. ON THE PRICE FRONT, THE GOVERNMENT HAS BROUGHT DIRECTLY ADMINISTERED PRICES SUCH AS UTILITY RATES AND PETROLEUM PRICES UP TO REALISTIC LEVELS. SECOND, IT HAS PERMITTED THE CAP SUPPORT LEVELS TO RAISE THE PRICES OF FOOD DOMESTICALLY. FINALLY, IT HAS REMOVED PRICE CEILINGS ON ALL INDUSTRIAL PRODUCTS AT THE PRODUCER LEVEL. THIS LEAVES IN PLACE FOR THE TIME-BEING THE INEFFECTIVE CONTROLS ON DISTRIBUTION MARGINS, WHICH APPEAR TO BE RISING, AND PRICE CEILINGS ON SERVICES AND ENERGY.

5. ALTHOUGH PRICES HAVE ACCELERATED IN THE PAST FEW MONTHS, THE ANNUAL RATE OF INCREASE HAS REMAINED BELOW 10 PERCENT ON A YEAR-TO-YEAR BASIS. FRANCE HAS BENEFITED FROM A RETURN TO MORE NORMAL AGRICULTURAL PRODUCTION AFTER A TWO YEAR DECLINE DUE TO THE 1976 DROUGHT. THE LEVELING OFF OF INTERNATIONAL RAW MATERIAL AND PETROLEUM PRICES, WHICH AN
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APPRECIATING FRANC, SINCE MARCH, HAS CONVERTED INTO FALLING DOMESTIC PRICES, HAS ALSO HELPED.

6. IT IS QUESTIONABLE HOW SERIOUS A PRICE RISE WILL OCCUR FROM THE LIFTING OF CEILINGS BECAUSE IT IS DIFFICULT TO BELIEVE THAT PROLONGED PRICE CEILINGS WITHOUT CONTROLS OVER SUPPLY EVER HAD ANY EFFECT OTHER THAN ON THE TIMING OF PRICE RISE.

THE USUAL ANECDOTE IS THAT THE PRICE OF PASTRY IS HIGH BECAUSE BREAD SELLS AT UNPROFITABLE LEVELS. FOR THE LONGER RUN, FREEDOM OF RELATIVE PRICES MAY HAVE A MORE POTENT EFFECT ON EFFICIENCY ALLOWING THEM TO REFLECT MARKET VALUATIONS MORE CLEARLY THAN IN THE PAST. OVER THE NEXT YEAR THERE MAY BE MECHANICAL EFFECTS ON THE INDICES THAT RAISE ITS LEVEL SLIGHTLY--I.E., BREAD IS MORE IMPORTANT THAN CAKE IN THE COL INDEX.

7. IN THE PERSPECTIVE OF A YEAR, THE SUCCESS OR FAILURE OF THE BARRE PLAN WILL BE MEASURED BY THE DEGREE TO WHICH PRICES RISE LESS RAPIDLY. THE KEY INFLUENCE WILL BE THE RATE OF INCREASE OF SALARIES. IT APPEARS THAT THE GOVERNMENT'S CONCERN TO RAISE THE LOWEST SALARIES BY PUSHING UP THE MINIMUM WAGE (SMIC) MORE RAPIDLY THAN PRICES LED AFTER THE ELECTION TO A VERY RAPID INCREASE OF HOURLY WAGES AND

PROBABLY THE WHOLE SALARY STRUCTURE THEN OR SOONAFTER.
THE FIRST INDICATION WE HAVE IS THE 5 PERCENT RATE
IN THE SECOND QUARTER, OR A 20 PERCENT ANNUAL RATE.
A BARRE LETTER TO MONORY OF SEPTEMBER 4 ASKING FOR
SANCTIONS AGAINST EMPLOYERS AGREEING TO EXCESSIVE WAGE
INCREASES THROUGH THE WITHHOLDING OF GOVERNMENT
CONTRACTS AND THE LIGHTENING OF CREDIT IS THE OFFICIAL
REACTION TO THESE STATISTICS WHICH WERE PUBLISHED LAST
WEEK. BUT THE EXTENT TO WHICH THE GOVERNMENT WILL
REALLY TAKE A TOUGH STAND WHEN CHALLENGED AND TAKE ON
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REALLY TAKE A TOUGH STAND WHEN CHALLENGED AND TAKE ON
THE POLITICAL BURDEN OF HOLDING DOWN PURCHASING POWER

IN ADDITION TO THE RESENTMENT CAUSED BY GROWING
UNEMPLOYMENT IS STILL OPEN TO QUESTION.

8. FORECAST ASSUMPTIONS. THEY ARE:

(A) THE WORLD ECONOMY AS A WHOLE WILL CONTINUE TO
GROW AT APPROXIMATELY THE PRESENT RATE THROUGH THE
END OF 1979.

(B) THE DOLLAR PRICE OF OIL WILL NOT RISE BY MORE
THAN 5 PERCENT FROM NOW UNTIL THE END OF 1979.

(C) NO BASIC CHANGE IN MONETARY AND FISCAL POLICY--
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I.E., THAT THE CURRENT CREDIT CEILING, WHICH
PERMITS UNDER CERTAIN ASSUMPTIONS A 12 PERCENT RISE
IN THE MONEY SUPPLY IN 1978, WILL ALLOW A SIMILAR
INCREASE IN 1979 AND THAT THE BUDGET DEFICIT NEXT YEAR
WILL NOT BE SIGNIFICANTLY LARGER THAN THIS YEAR (NO MORE
THAN 25-30 BILLION COMPARED TO 20-25 BILLION FRANCS IN
1978). (THE PRESENT PROGNOSIS IS FOR A 13 OR POSSIBLY
A 14 PERCENT INCREASE IN MONEY SUPPLY
PRINCIPALLY BECAUSE OF THE BALANCE OF PAYMENTS SURPLUS
IN 1978.

9. THE FORECAST--GNP

(IN PERCENT, IGNORING
INVENTORY CHANGES)

1977 1978 1979 1/

A. GDP	2.9	3.0	3.0--3.4
1. HOUSEHOLD CONSUMPTION	2.5	2.8	2.5--3.0
2. GOVERNMENT CONSUMPTION	2.6	5.0	3.0--3.0
3. INVESTMENT	-0.6	2.0	4.0--4.0
4. FOREIGN SECTOR	0.9	0.2	-- --

1/ THE OFFICIAL ESTIMATE IS 3.7 PERCENT.

10. THE SEMESTER PROFILE OF GDP

78-I/77II	78-II/78-I	79I/78II	79II/79I
2.5	1.0	2 (2.2)	2 (2.2)

11. THE GROWTH PROFILE SHOWS A FAIRLY VIGOROUS PICKUP
IN THE FIRST HALF OF 1978, PEAKING IN MAY-JUNE AS BOTH
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INTERNAL CONSUMPTION AND EXTERNAL DEMAND RAN OUT OF STEAM. THE MOST LIKELY HYPOTHESES ARE THAT CONSUMPTION WILL STABILIZE IN THE SECOND HALF AS REAL PURCHASING POWER IS HELD DOWN BY MORE RAPID PRICE INCREASES. EXPORT DEMAND SHOULD CONTINUE TO GROW AS WILL INDUSTRIAL INVESTMENT AND GOVERNMENT CONSUMPTION.

12. IN 1979, THE MAIN SPUR IN ADDITION TO CONSUMPTION WILL ARISE FROM INDUSTRIAL INVESTMENT IN COMBINATION WITH A STABILIZATION OF GOVERNMENT PUBLIC WORKS AND HOUSING WHICH HAVE BEEN DECLINING THE LAST COUPLE OF YEARS, A TREND EXPECTED TO BE EVIDENT IN THE SECOND HALF OF 1978. CONSUMPTION WILL DEPEND MAINLY ON THE PATTERN OF WAGE AND PRICE INCREASES. THE ASSUMPTION IS THAT UNPERTURBED BY SPECULATION ON THE ELECTION BOTH WILL MOVE MORE EVENLY NEXT YEAR.

13. THE BALANCE OF PAYMENTS

(BILLIONS OF FRANCS)

	1977	1978	1979
	(PROV)	(EST)	(PROJECTED)

TRADE BALANCE	-13.3	2.0	0
NET SERVICES	10.1	13.0	14.0
NET TRANSFERS	-12.8	-14.0	-L5.0
CURRENT ACCOUNT	-16.0	1.0	-1.0

THE MOST STRIKING DEVELOPMENT IN THE PAST YEAR IS THE STRONG IMPROVEMENT OF THE VISIBLE TRADE BALANCE. FRENCH EXPORTS HAVE APPARENTLY BEEN IMPROVING THEIR MARKET SHARES SLIGHTLY WHILE IMPORTS VALUED IN FRANCS HAVE BENEFITED FROM THE DOUBLE TREND OF STABILIZING RAW

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MATERIAL AND ENERGY PRICES COMBINED WITH AN APPRECIATING
FRANC. MOST OF THE IMPROVEMENT HAS BEEN IN THE TERMS OF
TRADE SO THAT THE SWING IS FAR LARGER HERE THAN IN THE
NATIONAL ACCOUNTS.

14. RETAIL PRICES

(DECEMBER TO DECEMBER)

1977	1978	1979
	(A)	(B)
9.0	10.5	9.0 10.0

THIS YEAR THE STRENGTH OF THE ADMINISTRATIVE ADJUSTMENTS,
THE ENDING OF PRICE CONTROLS, AND A SOMEWHAT LAX SALARY
POLICY IN MID-YEAR WILL COMBINE TO INCREASE INFLATION
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ABOVE THE 9 PERCENT TREND RATE. NEXT YEAR PRICES AS WELL
AS GNP WILL DEPEND ON THE SALARY PATTERN. A MORE RIGOR-
OUS GOVERNMENT POLICY COULD PUSH PRICE RISE BACK TO 9
PERCENT. (THE OFFICIAL ESTIMATE IS 8 PERCENT). A LAXER
ONE COULD LEAVE THE UNSATISFACTORY RESULT OF 10
PERCENT.

15. UNEMPLOYMENT

AT 3 PERCENT GNP GROWTH, THE NET ADDITION TO THE LABOR FORCE WILL ON BALANCE INCREASE THE NUMBER OF UNEMPLOYED. THE NON-AGRICULTURAL LABOR FORCE DECLINED 150,000 FROM THE END OF 1976 TO THE END OF MARCH 1978, AND THE TREND CONTINUES TO BE DOWN. THE UNEMPLOYMENT RATE IS NOW 6.0 PERCENT AND CAN BE EXPECTED TO RISE OVER THE NEXT YEAR BY SEVERAL MORE TENTHS OF ONE PERCENT. ABOUT HALF ARE LESS THAN 25 YEARS OLD. THE DIFFICULT AREAS ARE IN THE WEST, THE REGIONAL POCKETS IN THE EAST CAUSED BY THE DEPRESSED STEEL AND TEXTILE INDUSTRIES, AND THE PORT CITIES CONCENTRATING ON SHIPBUILDING. BUT LAYOFFS CONTINUE ALL OVER THE COUNTRY WITH ASSENT OF THE GOVERNMENT, A BASIC CHANGE FROM THE PAST.

16. THE EXCHANGE RATE

THE FRANC/DOLLAR RATE STRENGTHENED STEADILY ALL YEAR. IT HAS GONE THROUGH THREE PHASES SO FAR THIS YEAR--WEAKNESS PRIOR TO THE ELECTIONS IN MARCH, CAPITAL INFLOWS AFTER THE GOVERNMENT VICTORY UNTIL JUNE, AND THE STRENGTH OF THE EMS CONNECTION SINCE. WITH THE PUBLICATION OF THE JULY PRICE INDEX AND THE WORRIES OVER LABOR TROUBLE THIS FALL, IT IS NOT QUITE AS STRONG RIGHT NOW. OUR GUESS/ESTIMATE IS THAT IT CONFIDENTIAL

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WILL FLUCTUATE IN THE 4.30/\$1--4.50/\$1 RANGE UNTIL THE END OF THE YEAR.

17. CONCLUSIONS

BARRE AND GISCARD (WHO HAS BEEN VERY SUCCESSFUL IN LETTING HIS PRIME MINISTER TAKE THE POLITICAL LUMPS) ARE ENGAGED IN A VERY BOLD AND DIFFICULT UNDERTAKING: TO RESTRUCTURE AND STABILIZE THE FRENCH ECONOMY AT THE SAME TIME. IN THE POLITICAL SPHERE THE DOUBLE TASK MULTIPLIES RESISTENCE AND REACTIONS. FROM THE ECONOMIC POLICY POINT OF VIEW, STABILIZATION

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IS BEST DONE IN A PERIOD OF SLOW GROWTH WHILE A
REDIRECTION OF RESOURCES IS FACILITATED BY A HIGHER
LEVEL OF ACTIVITY. THE GOVERNMENT HAS SHOWN ITS
DETERMINATION TO MOVE ON ITS LONG RANGE PLANS BY
THE ENDING OF PRICE CONTROLS, THE CALL FOR MORE
COMPETITION IN AREAS IT CONTROLS SUCH AS PETROLEUM
REFINING AND MARKETING, AND ITS PASSIVE ATTITUDE TO
PLANT CLOSINGS. ON THE STABILIZATION FRONT, IT HAS
KEPT FAIRLY STRICT CONTROL OVER BANK CREDIT AND THE
BUDGET DEFICIT. BUT IT DID NOT TAKE A VERY STRONG
POSITION ON THE SALARY ISSUE AFTER THE ELECTION.
ON THE CONTRARY, ITS PRE-ELECTORAL TOUGH VIEWS SEEMED
TO HAVE RELAXED. ALTHOUGH BARRE HAS NOW REASSERTED
HIS EARLIER POSITION, IT IS BY NO MEANS YET CLEAR HOW
FAR HE IS PREPARED TO GO, PARTICULARLY IF HE IS
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CHALLENGED BY WIDESPREAD SOCIAL UNREST AND STRIKES.

18. WHAT, UNDER THESE CIRCUMSTANCES, DOES GISCARD'S
COMMITMENT TO EMS MEAN? BARRE SAID PUBLICALLY ONLY
RECENTLY THAT HE EXPECTS TO SEE A STABLE RELATIONSHIP
BETWEEN THE FRANC AND THE DEUTSCHEMARK. HIS POLICIES
SUGGEST THAT HE IS ASSUMING THAT SEVERAL YEARS WILL

GO BY BEFORE THAT RELATIONSHIP IS REACHED. FOR THAT
REASON, THE FRENCH CAN BE EXPECTED TO INSIST ON
LINKING THEIR CURRENCY TO THE MORE FLEXIBLE ECU
BASKET INSTEAD OF DIRECTLY TO THE DEUTSCHEMARK AND
ON A LARGE FUND IN THE EMS FROM WHICH TO PROVIDE
BALANCE OF PAYMENTS CREDITS.
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